CHAPTER - III
MERITS OF LEASE FINANCING

The merits of lease financing are merits inherent in leasing as a finance function, merits associated with leasing companies being in the private sector and practical advantages of leasing.

3.1 Merits inherent in leasing:

**Cent percent financing:**– Leasing an equipment is equivalent to a cent percent loan. The lessee can use the equipment without paying anything towards the cost but for the payment of rent. No other mode of institutional finance offers such a facility. Hence, firms which are short of cash (less liquid) can always prefer this mode of finance for acquiring assets.

**Tax benefit:**– Lease rent is an operating expense and can be charged to the revenue account. To that extent, profit can be reduced and this gives an ultimate tax savings to the lessee. The entire lease payments comprising both principal and interest amounts are operating expenses and allowable for tax deduction. Besides, the lessor company can also show depreciation as a charge on profits which further reduces the tax burden.
Leaves the borrowing capacity of the lessee unaffected: The debt equity ratio remains the same inspite of leasing. The leased asset does not appear in the Balance Sheet. Lessee can raise loans as leasing does not in any way limit the borrowing capacity of the lessee.

Sale and lease back technique:- Once the lessee gets exhausted of his financial outlets, sale and lease back technique comes in handy for further raising of funds. The existing assets are sold to a leasing company and they are leased back. There is no physical movement of assets but simply a book entry for recording the transaction. The lessee company enjoys the benefit of taking existing capital assets off the balance sheet without disrupting its activities.

Piece - meal financing device:- If a firm is expanding by adding relatively smaller amounts of fixed assets at regular intervals, it will have to locate the funds also at regular intervals for financing its activities. Raising loans or issuing bonds at frequent intervals will be expensive and time consuming. Under such situations, lease financing is a convenient and cheap mode of financing.
As much finance as required:— In case of bank borrowings or loans from financial institutions there exist a limit upto which credit can be extended to a company, keeping in view the debt equity ratio, nature of the industry, the purpose of the loan etc. Similarly, there exists a limit on levels of fixed deposits/debentures which can be raised by a company from the public. There is no such limit or constraint in the case of lease finance. For efficiently managed, growing and expanding companies, as much finance as required can be raised through lease financing.

An insurance against out of date technology:— When technology is rapidly changing, leasing provides a cushion for the lessee by shifting the risk of obsolescence to the lessor. The operating lease contains a revocable clause and provides a leverage to the lessee to cancel the lease when the equipment becomes obsolete.

Elimination of equipment disposal problem:— On the expiry of the lease term, the lessor takes away the leased property. The lessee need not bother about the disposal of the obsolete and wornout asset.

Avoidance of bankruptcy risk:— The leased amount is not regarded as a debt and hence there are no risks
of bankruptcy. The lessor can at the maximum take away his assets after due serving of notices.

No dilution of present management:— On buying an asset on lease, the need for raising further equity is done away with and changes in shareholding pattern is prevented. It is a plus point for the existing management as there is no dilution of control.

Convenient administration:— While assets are acquired on lease basis, the documentation formalities are negligible. There is no need for maintaining detailed depreciation tables and this makes the book keeping methods very simple.

Possibility of clubbing other costs:— Additional charges in acquiring equipments, such as delivery and installation charges, inspection costs, consultants' fees, interest charges tied up in advance payments, and other incidental or ancilliary costs, may be added to the capital cost of an asset and amortised over the lease period.

3.1 Merits associated with leasing Companies being in the private sector:

Leasing companies, which number about 1400, are mostly in the private sector. Existence in the private sector has
provided certain benefits to leasing companies, which other financial institutions do not enjoy. The prominent financial institutions are IDBI, IFCI, NIDC, ICICI, NSIC, LIC, SFC, SIDC, IRCI, etc. They grant loans for acquiring assets. But the legal formalities, restrictions and procedural delays inherent in these institutions make them less attractive to the borrowers.

Flexibility in payment of lease rentals:— Leasing arrangements are very flexible. Leasing companies have proved more adaptable than banks and financing institutions with regard to contract structures - Rental payments may be varied according to the revenue expectations of lessees, and arrangements such as "balloon payments" at the front end or back end of leases, "stepped rentals" and so on may be made to suit a lessee's book.

Adjustment in the duration of the lease period:— The duration of the lease period is always adjusted according to the convenience of the lessee. The primary period may range from 4 to 8 years and secondary from 5 to 10 years. The rental payment period may also be adjusted to suit the needs of the lessee - monthly, quarterly, half yearly or even yearly - Banks and financial institutions may not be that much liberal to the lessee.
Immediate availability of funds:— For obtaining lease finance the procedural difficulties are less and documentation is very simple. Quick disbursement of money by cutting down cumbersome procedure is possible. Loans from banks and other financial institutions require elaborate formalities and lengthy procedures. In the case of debt raising, there are problems related to creation of mortgage on assets, appointment of trustees for debentureholders and payment of stamp duty.

No government control:— Lease finance is the only source of finance available without any government control either on the amount of loan or on the rate of interest. The RBI controls the capacity of banks and financial institutions to create credit through various measures especially in times of inflation. The expansion programmes and even the current working of probable lessees get paralysed under such conditions.

Leasing companies are liberal:— Leasing companies are not particular about the purpose for which the leased assets are put to. They accommodate activities which are given less priority or even denied by banks and other financial institutions.

No interference by the lender:— The lessee is free to
use the asset without the lessor's interference thus avoiding any encounter between the two. Financial institutions may attach strips like convertibility clause or inclusion of their nominee in the director board restricting the freedom of the lessee.

Escape from asset based restrictions: In India, MRTP and FERA companies are closely monitored by the Government and are not allowed to expand beyond certain limits. MRTP Act defines big companies as those whose total assets are in excess of Rs. 20 crores. Since a leased asset is not an asset owned by the lessee (it is an asset of the lessor company), leasing some assets can help big companies to escape the asset based restrictions. Leasing comes as a blessing in disguise to such companies for acquiring unavoidable assets.

Budget preparation made easier: As lease rentals are definite and certain, the budget preparation can be made easier.

3.3 Practical Advantages:

Citing some practical advantages in going for lease financing will certainly benefit shrewd businessmen.

Corporate bodies which are financially sound, but have tax
liabilities, find it more economic to lease unproductive assets, i.e., assets which do not directly participate in the production process of the company and which do not generally qualify for multiple shift depreciation. These are assets like vehicles, refrigerators, air conditioners etc., which may be taken on lease for a five year period. At the end of the lease period, the asset remains the property of the lessor and can be made available to the lessee for a nominal value (generally not more than 2 percent of the original acquisition cost). The lessee company instead of acquiring the asset, can direct the lessor to sell the asset to one of its employees who is to be rewarded.

2. In the private sector today, only top management personnel are provided with company vehicles. Other levels of management are generally provided loans (at concessional rates of interest) to purchase vehicles - cars, scooters or mopeds. The differential in interest, till recently, was considered a perquisite and was taxable. Apart from interest, the repayment of the loan is a burden for the employee and, however well paid he is, finds it difficult to leave sufficient saving after meeting his other personal commitments. In such a situation, the company offering the loan may not be sure of boosting the morale of the beneficiary. Besides, the company
has to raise sufficient funds to give loans. In such cases, profit making corporate bodies can work out a scheme whereby the company acquires vehicles on lease basis and then arranges with the lessor (leasing company) for an outright sale of the leased asset to the employee at a nominal price, when the company wants to give the benefit. This is totally outside the tax orbit of the company.

Inspite of the numerous merits associated with leasing, the functioning of the industry is handicapped due to a series of regulations which prevent it from blossoming and flourishing.